

Report  
of the  
Examination of  
West Central Mutual Insurance Company  
Whitehall, WI  
As of December 31, 2002

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

*Jim Doyle, Governor*  
*Jorge Gomez, Commissioner*

*Wisconsin.gov*

November 17, 2003

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Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of  
December 31, 2002, of the affairs and financial condition of

WEST CENTRAL MUTUAL INSURANCE COMPANY  
Whitehall, Wisconsin

and the following report thereon is respectfully submitted:

## I. INTRODUCTION

The last examination of this company was made in 1999 as of December 31, 1998.  
The current examination covered the intervening time period ending December 31, 2002, and  
included a review of such subsequent transactions deemed essential to complete this  
examination.

The Summary of Examination Results contains elaboration on all areas of the  
company's operations. Special attention was given to the action taken by the company to satisfy  
the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on  
January 3, 1871, under the provisions of the then existing Wisconsin Statutes. The original name  
of the company was the Trempealeau County Farmers Mutual Fire Insurance Company.  
Subsequent amendments to the company's articles and bylaws changed the company's name to  
that presently used.

During the period under examination, there were no amendments to the articles of incorporation and two amendments to the bylaws. The amendments to the bylaws allow the Secretary and Treasurer to be one and the same person, and establish an executive committee.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Trempealeau, Buffalo, Jackson, La Crosse, Clark,  
Eau Claire, Pepin, Dunn, Vernon, and Monroe

The company is currently licensed to write property, including windstorm and hail, and non-property insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one, three, six or twelve months with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through thirty-nine agents, three of whom are directors of the company. Agents are presently compensated for their services as follows:

<b>Type of Policy</b>	<b>Compensation</b>
All Business- New	14 %
All Business- Renewal	14 %

Agents have authority to adjust losses only if assigned by the Secretary. The company has a salaried employee specifically for adjusting claims.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

#### **Board of Directors**

The board of directors consists of seven members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for

the unexpired term or the board may adjust the number by resolution. Further comment about the board of directors is found in the "Current Examination Results" section of this report.

The current board of directors consists of the following policyholders of the company:

<b>Name</b>	<b>Principal Occupation</b>	<b>Residence</b>	<b>Expiry</b>
Steven Hogden*	Farming	Galesville, WI	2004
Daniel Lilla	Farming	Trempealeau, WI	2006
Gary Monson	Farming	Strum, WI	2005
Danny Hanson	Sales	Alma, WI	2005
Harlan Vold*	Farming	Osseo, WI	2005
Ellen Koxlien*	Manager of the company	Whitehall, WI	2004
Dean Boehne	CPA	Strum, WI	2005

Directors who are also agents are identified with an asterisk

Members of the board currently receive \$50.00 for each meeting attended, if a whole day is involved they receive \$75.00, and they receive \$.36 per mile for travel expenses in either case.

### **Officers**

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

<b>Name</b>	<b>Office</b>	<b>2002 Salary*</b>
Harlan Vold	President	\$ 4,343
Daniel Lilla	Vice-President	1,225
Ellen Koxlien	Secretary/Treasurer/Manager	37,651

\*Includes commissions, meeting fees, mileage, and salaries.

### **Committees of the Board**

The company's bylaws allow for the formation of certain committees by the board of directors. The committee members are paid the same amounts as the board members listed above. The committees at the time of the examination are listed below:

#### **Adjusting Committee**

Harlan Vold, Chair  
Ellen Koxlien  
Danny Hanson  
Daniel Lilla

#### **Executive Committee**

Harlan Vold, Chair  
Ellen Koxlien  
Daniel Lilla

**Audit and Investment Committee**

Harlan Vold, Chair  
Ellen Koxlien  
Dean Boehne  
Steven Hogden

**Underwriting Committee**

Harlan Vold, Chair  
Ellen Koxlien  
Dean Boehne

**Agency Committee**

Harlan Vold, Chair  
Ellen Koxlien  
Daniel Lilla  
Gary Monson  
Steven Hogden

**Form and Rates Committee**

Harlan Vold, Chair  
Ellen Koxlien  
Daniel Lilla  
Danny Hanson

**Personnel Committee**

Harlan Vold, Chair  
Ellen Koxlien  
Steve Hogden  
Gary Monson  
Daniel Lilla

## Growth of Company

The growth of the company during the past three years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2002	\$464,021	\$373,163	1,397	(\$ 4,686)	\$1,147,209	\$706,284
2001	403,802	419,045	1,326	(123,986)	1,245,085	833,872
2000	419,060	419,914	1,309	(111,753)	1,389,746	947,427
1999	330,788	254,608	1,323	2,715	1,247,415	908,536

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
2002	\$874,270	\$483,622	\$706,284	123.8%	68.5%
2001	744,716	418,498	833,872	89.3	50.2
2000	702,920	472,293	947,427	74.2	49.9
1999	686,161	328,735	908,536	75.5	36.2

For the same period, the company's operating ratios were as follows:

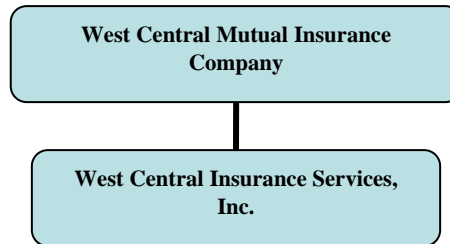
Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
2002	\$373,163	\$214,785	\$464,021	80%	45%	125%
2001	419,045	201,763	403,802	104	48	152
2000	419,914	210,642	419,060	100	45	145
1999	254,608	187,464	330,788	77	57	134

During the four year period, the company has suffered several bad years. The company's surplus has decreased \$202,252 or 22%, and admitted assets have declined \$100,206 or 8%. Contributing to this decline is the company's poor loss experience over the past three years. The company's poor loss experience and investment performance coupled with its expenses has resulted in net losses over the last three years. The policies in force have increased approximately 6% to 1,397. The company has increased rates and lowered commissions in an effort to help the company become profitable. The company has also looked into the possibility of merging with other town mutual insurers in the area.

## II. AFFILIATED COMPANIES

West Central Mutual Insurance Company is a member of a holding company system. It is the ultimate parent. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the affiliate follows the organizational chart.

### Holding Company Chart As of December 31, 2002



#### **West Central Insurance Services, Inc.**

West Central Insurance Services, Inc. (WCIS), was created by West Central Mutual Insurance Company (West Central) as a means to market insurance products and service policies in the event West Central purchases a block of business from an independent agency. The initial capitalization of the agency was to be \$110,000 with West Central holding 100% of the outstanding shares; however, the company chose to issue only \$20,000 in shares of common stock. WCIS, through its licensed agents, sells both property and casualty and life and health business. WCIS has a Services Agreement with West Central. The agreement calls for West Central to pay WCIS's expenses for which West Central is then reimbursed by WCIS. Annually, West Central estimates the total WCIS expenses which then WCIS repays monthly. A 13 month true up billing is generated at the end of each year. The WCIS fee for 2002 was \$3,914 per month. Prior to 1998, WCIS was not reimbursing West Central for these expenses. Hence, West Central showed a receivable from WCIS. This balance had been non-admitted since the last examination. WCIS has been making its monthly payments since the last examination and has paid down the past due amount. The examiners were informed that WCIS will pay the June 30, 2003, balance in a little over a year.

At the time of the last examination WCIS had purchased four blocks of business. Two of these blocks of business were purchased with multiple year payments. They were completely paid in full during 2002.

### III. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2003
Termination provisions:	At any January 1 by either party giving 90 days prior written notice.

The coverage provided under this treaty is summarized as follows:

- |                      |   |
|----------------------|---|
| Type of contract:    | Class A – Excess of Loss Reinsurance    |
| Lines reinsured:     | All non property written by the company |
| Company's retention: | \$1,250 per loss occurrence             |
| Coverage:            | 100% excess of company retention        |
| Reinsurance premium: | 65% of premiums written                 |
- |                      |   |
|----------------------|---|
| Type of contract:    | Class B – First Surplus Reinsurance   |
| Lines reinsured:     | All property business written by the company  |
| Company's retention: | When the company's net retention is \$350,000 or more in respect to a risk, the company may cede on a pro rata basis up to \$800,000<br><br>When the company's net retention is \$350,000 or less in respect to a risk, the company may cede on a pro rata basis up to 50% of such risk |
| Coverage:            | Pro rata share of each and every loss including loss adjusting expense  |
| Reinsurance premium: | Pro rata portion of premiums corresponding to amount of each risk ceded plus 100% of the pro rata unearned premium applicable to business covered as of January 1, 2003   |
| Ceding commission:   | 15% standard sliding commission<br><br>Minimum Commission: 15%<br>Maximum Commission 35%  |
- |                   |                                      |
|-------------------|--------------------------------------|
| Type of contract: | Class C-1 First Layer Excess of Loss |
|-------------------|--------------------------------------|

	Lines reinsured:	All property business written by the company
	Company's retention:	\$35,000 per loss occurrence
	Coverage:	100% of any loss including loss adjusting expenses in excess of company retention up to \$65,000
	Reinsurance premium:	12.5% of net premiums written with a minimum premium of \$67,200
4.	Type of contract:	Class C-2 Second Layer Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	\$100,000 per loss occurrence
	Coverage:	100% of any loss including loss adjusting expense in excess of company retention up to \$250,000
	Reinsurance premium:	2.5% of net premiums written, subject to a minimum premium of \$13,500
5.	Type of contract:	Class D/E – Stop Loss
	Lines reinsured:	All business written by the company
	Company's retention:	60% of net premiums written, minimum retention of \$355,000
	Coverage:	100% of aggregate net losses in excess of 60% of net premiums written
	Reinsurance premium:	Current year rate is 10.64% with a minimum premium of \$63,000

#### **IV. FINANCIAL DATA**

The following financial statements were filed with the Commissioner of Insurance for December 31, 2002. Adjustments made as a result of the examination are noted in the "Reconciliation of Policyholders' Surplus" at the end of this section.

**West Central Mutual Insurance Company**  
**Statement of Assets and Liabilities**  
**As of December 31, 2002**

<b>Assets</b>	<b>Ledger</b>	<b>Nonledger</b>	<b>Not Admitted</b>	<b>Net Admitted</b>
Cash in Company's Office	\$ 100	\$	\$	\$ 100
Cash Deposited in Checking Account	6,229			6,229
Cash Deposited at Interest	184,399			184,399
Bonds (at Amortized Cost)	112,663			112,663
Stocks or Mutual Fund Investments (at Market)	533,092			533,092
Real Estate	250,495			250,495
Premiums and Agents' Balances and Installments: In Course of Collection	4,426			4,426
Investment Income Accrued		2,619		2,619
Reinsurance Recoverable on Paid Losses and LAE	15,832			15,832
Electronic Data Processing Equipment	3,338			3,338
Other Assets:				
Expense Related:				
Other Assets	1,304		1,304	
Cash Surrender Value	29,616			29,616
Nonexpense Related:				
Federal Income Tax Recoverable	4,400			4,400
Due From Agency	36,830		36,830	
Furniture and Fixtures	<u>11,847</u>	<u>          </u>	<u>11,847</u>	<u>          </u>
<b>TOTALS</b>	<b><u>\$1,194,571</u></b>	<b><u>\$2,619</u></b>	<b><u>\$49,981</u></b>	<b><u>\$1,147,209</u></b>

**West Central Mutual Insurance Company**  
**Statement of Assets and Liabilities (cont.)**  
**As of December 31, 2002**

**Liabilities and Surplus**

Net Unpaid Losses	\$ 13,358
Unpaid Loss Adjustment Expenses	150
Commissions Payable	5,554
Fire Department Dues Payable	589
Unearned Premiums	244,083
Reinsurance Payable	116,964
Other Liabilities:	
Expense Related:	
Accounts Payable	
Accrued Property Tax	3,990
Accrued Vacation and Sick Pay	15,722
Pension Liability Payable	21,257
Nonexpense Related:	
Premiums Received	
in Advance	17,008
Other Liabilities	<u>2,250</u>
TOTAL LIABILITIES	440,925
Policyholders' Surplus	<u>706,284</u>
TOTAL	<u>\$1,147,209</u>

**West Central Mutual Insurance Company**  
**Statement of Operations**  
**For the Year 2002**

Net Premiums and Assessments Earned		\$464,021
Deduct:		
Net Losses Incurred	272,608	
Net Loss Adjustment Expenses Incurred	100,555	
Other Underwriting Expenses Incurred	<u>214,785</u>	
Total Losses and Expenses Incurred		<u>587,948</u>
Net Underwriting Gain (Loss)		(123,927)
Net Investment Income:		
Net Investment Income Earned	25,680	
Net Realized Capital Gains	<u>(165)</u>	
Total Investment Income		<u>25,515</u>
Other Income:		
Policy Fees and Miscellaneous Income	<u>73,825</u>	
Total Other Income		<u>73,825</u>
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes		(24,587)
Net Income (Loss) Before Federal Income Taxes		(24,587)
Federal Income Taxes Incurred		<u>(99)</u>
Net Income (Loss)		<u>(\$24,686)</u>

**West Central Mutual Insurance Company**  
**Reconciliation and Analysis of Surplus as Regards Policyholders**  
**For the Four-Year Period Ending December 31, 2002**

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
Surplus, beginning of year	\$833,872	\$947,427	\$908,536	\$971,195
Net income	(24,686)	(123,986)	(111,753)	2,715
Net unrealized capital gains or (losses)	(142,111)	(34,588)	128,655	(17,101)
Change in non-admitted assets	39,209	45,019	21,989	(27,716)
Other gains and (losses) in surplus:				
Correct errors Pension & Sick Leave				(20,557)
Surplus, end of year	<u>\$706,284</u>	<u>\$833,872</u>	<u>\$947,427</u>	<u>\$908,536</u>

### Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2002 is accepted.

Reclassification Account	Debit	Credit
Accounts Payable	\$2,250	
Loss Reserve	<u>          </u>	<u>\$2,250</u>
Total	<u>\$2,250</u>	<u>\$2,250</u>

## V. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records —It is recommended that the minutes for all committees of the board be maintained and included with the minutes of the board of directors.

Action—Compliance.

2. Agency Operations —It is recommended that the company, in accordance with Chapter Ins 40, Wis. Adm. Code, properly and correctly file all required holding company filings for the agency for all future years.

Action—Compliance.

3. Agency Operations —It is recommended that the company, in accordance with Chapter Ins 40.04 (2), Wis. Adm. Code, properly report transactions with affiliates.

Action—Compliance.

4. Accounts and Records — It is recommended that the company properly account for void check numbers.

Action—Compliance.

5. Due from Agency — It is recommended that the company either follow the terms of the agreement by enforcing monthly payments, amend the agreement to include a different plan, but not less than quarterly payments, or issue a loan, subject to OCI approval, to the agency to satisfy the debt.

Action—Compliance.

6. Accounts Payable — It is recommended that the company properly report the accrued amount of accumulated sick leave on all future annual statements.

Action—Compliance.

7. Pension Benefits Payable — It is recommended that the company include the value of pension benefits payable and admit the cash surrender value of the life insurance policy on all future annual statements.

Action—Compliance.

## **Current Examination Results**

### **Corporate Records**

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent period.

The membership of the board of directors has ranged from the current seven to eleven members under the years of examination. Article III of the company's articles of incorporation states the board may adjust the membership of the board, by resolution, between seven and fifteen members. The board has not made any resolutions to change the number of board members. It is recommended that when the board wishes to change the number of members on the board that it does so by resolution according to Article III of the company's articles of incorporation. During the review of the minutes, it was also noted that members of committees were not always listed in the minutes. Minutes would sometimes refer to committee members being the same as last year, but the minutes from the previous year would also have the same notation. It is recommended that the board minutes reflect what committees are being assigned and list the members of each committee and the chairman of each committee.

Pursuant to s. 612.13 (1), Wis. Stats., the directors terms should be divided into three classes as nearly equal as possible. There are two directors with terms expiring in 2004, four that expire in 2005, and one that expires in 2006. It is recommended that the company divide the classes into more evenly distributed classes pursuant to s. 612.13 (1), Wis. Stats.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

### **Conflict of Interest**

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to

conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with apparent conflicts being noted. It was noted that on two different occasions, directors with a conflict of interest did not abstain from that vote. One involved a salary and the other involved taking over business not assigned by the agency. It is recommended that those directors who have indicated a conflict of interest abstain from voting when such a conflict exists, pursuant to ss. 612.18 and 611.60, Wis. Stats.

### **Fidelity Bond and Other Insurance**

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

<b>Type of Coverage</b>	<b>Coverage Limits</b>
Professional and D&O Insurance	\$2,000,000 Each Claim \$2,000,000 Aggregate
Building	\$303,900 \$250 Deductible
Personal Property	\$50,000 \$250 Deductible
Liability	\$2,000,000 Aggregate \$1,000,000 Products \$1,000,000 Personal and Advertising \$10,000 Money and Securities on Premises \$5,000 Money and Securities off Premises
Workers Compensation Employers Liability	Statutory \$100,000 each accident \$100,000 each disease \$500,000 limit on disease
Fidelity Bond Coverage	\$100,000 Forgery \$2,500 Deductible \$100,000 Securities \$2,500 Deductible \$100,000 Trading Loss \$2,500 Deductible

The company reported the incorrect insurance company of their Fidelity Bond Insurance coverage on the Annual Statement. It is recommended that the company report the correct name of its Fidelity Bond insurer on the Annual Statement.

**Underwriting**

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and of renewal business is inspected by a company inspector who does not write insurance. The company has instituted a new policy of withholding commissions from agents until all the necessary paperwork has been furnished.

The company monitors its agents' loss performance, but does not have a formal written performance standard. Also, the company does not have a process for review and termination, if the performance standard is not met by its agents. It is recommended that the company develop a written performance standard for its agents and that the company develop a process to review agent performance, such process should include appropriate remedial action for those agents who do not meet the performance standard.

**Agency Operations**

The company established an agency, West Central Insurance Services, Inc., which was described in the section of this report entitled "Affiliated Companies". Establishing this agency subjected the company to Chapter Ins 40, Insurance Holding Company System Regulation, Wis. Adm. Code. In accordance with Chapter Ins 40, Wis. Adm. Code, the company is required to make certain filings in relation to this subsidiary. This includes the annual registration statement, Form B, the summary registration statement, Form C, and any other filings, which may be required, by the administrative rule. The company has made the appropriate holding company filings since the last examination.

The last examination of the company revealed that the agency had not been reimbursing the company on a monthly basis as required under the agreement. Since the last examination, the agency has been remitting its monthly balances and has paid back most of the original monthly installments that were unpaid. The examiners estimate that the agency will be current in a little over a year, if the agency continues paying back the average amount of the past five years.

### **Claims Adjusting**

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

### **Accounts and Records**

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2002.

The company is audited annually by an outside public accounting firm.

### **EDP Environment**

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computer is limited to people authorized to use the computers.

Company personnel back up the computers daily and the backed-up data is kept on-site, Friday's back-up data is kept off-site.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

## Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan. The company's disaster recovery plan appears to be adequate.

## Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

## Investment Rule Compliance

The investment rule for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$740,925
2. Liabilities plus 33% of gross premiums written	729,434
3. Liabilities plus 50% of net premiums written	682,736
4. Amount required (greater of 1, 2, or 3)	740,925

5. Amount of Type 1 investments as of 12/31/2002	<u>412,453</u>
6. Excess or (deficiency)	<u>(\$328,472)</u>

The company does not have sufficient Type 1 investments.

The company was granted exceptions under s. Ins 6.20, Wis. Adm. Code, to hold Wisconsin Reinsurance common stock, Wisconsin Reinsurance preferred stock, NAMIC stock, West Central Mutual Agency, and Real Estate. The company also was granted permission to hold up to 50% of its admitted assets in Wisconsin Reinsurance common stock and 5% of admitted assets in other common stock.

## **ASSETS**

<b>Cash and Invested Cash</b>	<b>\$190,728</b>
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The above asset is comprised of the following types of cash items:

Cash in company's office	\$ 100
Cash deposited in banks-checking accounts	6,229
Cash deposited in banks at interest	<u>184,399</u>
 Total	 <u><b>\$190,728</b></u>

Cash in the company's office at year-end represents the company's petty cash fund.

A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of two accounts maintained in two banks. Verification of checking account balances was made by obtaining confirmations directly from the depositories and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of ten deposits in seven depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2002 totaled \$8,390 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.65% to 3.02%. Accrued interest on cash deposits totaled \$928 at year-end.

The examiners reviewed voided checks. Several checks were found that were not marked void and the un-voided checks were stored in an unsecured area, accessible to persons other than authorized company employees. It is recommended that the company properly mark checks void and keep voided checks in a secure place.

During the search for unrecorded liabilities, it was discovered that the company did not accrue for some bills relating to 2002. The amount was not material; however, it is recommended that the company properly accrue for unrecorded liabilities at year-end according to the Annual Statement Instructions.

**Book Value of Bonds****\$112,663**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2002. Bonds owned by the company are located in an account with its safekeeper.

Bond statement from the safekeeper was reviewed by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2002 on bonds amounted to \$9,312 and was traced to cash receipts records. Accrued interest of \$1,691 at December 31, 2002, was checked and allowed as a nonledger asset.

**Stocks and Mutual Fund Investments****\$533,092**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2002. Stocks owned by the company are located in the company safe or held by a safekeeper.

Stock certificates were physically examined and the safekeeper statement was reviewed by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance or permitted variances as regards investments made by town mutual insurers.

Dividends received during 2002 on stocks and mutual funds amounted to \$4,438 and were traced to cash receipts records. There were no accrued dividends at December 31, 2002.

**Book Value of Real Estate****\$250,495**

The above amount represents the company's investment in real estate as of December 31, 2002. The company's real estate holdings consisted of its home office building.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted

under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

**Agents' Balances or Uncollected Premiums** **\$4,426**

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset. It was noted during the review that the company did not non-admit the amount in excess of 90 days. No adjustment to this account was made because the amount was not material. However, it is recommended that the company non-admit amounts in Agents' Balances or Uncollected Premiums over 90 days pursuant to the Annual Statement Instructions.

**Investment Income Due and Accrued** **\$2,619**

Interest due and accrued on the various assets of the company at December 31, 2002, consists of the following:

Cash at Interest	\$ 928
Bonds	<u>1,691</u>
Total	\$2,619

This amount was verified by tracing to subsequent receipt of accrual.

**Reinsurance Recoverable on Paid Losses** **\$15,832**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2002. A review of year-end accountings with the reinsurer verified the above asset.

**Electronic Data Processing Equipment** **\$3,338**

This asset consists of \$3,338 of computer equipment owned by the company at December 31, 2002. A review of the listing of equipment was used to verify the above asset.

**Cash Surrender Value** **\$29,616**

This asset consists of \$29,616 of cash surrender value of life insurance on the company's manager owned by the company at December 31, 2002. The above asset was confirmed by reviewing the applicable statement for the life insurance policy.

**Federal Income Tax Recoverable** **\$4,400**

This asset consists of \$4,400 of income tax refund owed to the company at December 31, 2002. The above asset was confirmed by tracing the amount of the recovery to the tax return filed by the company. This amount was received in 2003.

**Due From Agency** **\$36,830**

This asset consists of \$36,830 of amounts owed by the agency, WCIS, for services performed in 1998 by the company and due to the company at December 31, 2002. The balance was traced to supporting documentation. The agency is making monthly payments on current expenses as well as paying down this receivable. The examination estimates the agency will pay off this balance in a little over one year. In accordance with annual statement requirements, this amount has been deducted as a non-admitted asset.

**Equipment, Furniture, and Supplies** **\$11,847**

This asset consists of \$11,847 of equipment, furniture and supplies owned by the company at December 31, 2002. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

**Other Assets** **\$1,304**

This asset consists of \$1,304 of an amount owed by an employee for the purchase of used computer equipment and accumulation of small underpayments owed to the company at December 31, 2002. The balance was traced to the proper supporting documentation. In accordance with annual statement requirements, this amount has been deducted as a non-admitted asset.

## LIABILITIES AND SURPLUS

### Net Unpaid Losses

**\$15,608**

This liability represents losses incurred on or prior to December 31, 2002, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus".

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	\$129,124	\$147,104	(\$17,980)
Less:			
Reinsurance Recoverable on Unpaid Losses	<u>115,766</u>	<u>130,638</u>	<u>(14,872)</u>
Net Unpaid Losses	<u>\$ 13,358</u>	<u>\$ 16,466</u>	<u>(\$ 3,107)</u>

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2002. Included in the examiners' development is \$2,250 from a reclassification entry from Other Liabilities. This amount is the retention the company owes on two liability claims. To the actual paid loss figures was added an estimated amount for those 2002 and prior losses remaining unpaid at the examination date, if any. The above difference of \$3,107 was not considered material for purposes of this examination. This is due in part to the difference being mostly due to a reclassification entry from Other Liabilities to Unpaid losses for liability loss retention owed to the reinsurer. See the Other Liabilities section below. It is recommended that the company properly report all losses unpaid as net unpaid losses on its annual statement. During the development, it was also noted the company did not estimate IBNR for liability losses. The examiner found that three out of the last four years the company should have reported IBNR, since liability losses were actually incurred in the reporting year and reported in the subsequent years. Due to immateriality of this amount, an adjustment was not made. It is recommended that the company estimate an IBNR for liability losses each year.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review

indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss.

In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

#### **Unpaid Loss Adjustment Expenses**

**\$150**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2002, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is an estimate made by the company for incidental expenses relating to loss adjusting. The company uses mostly its in-house adjustor for claims settlement.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

#### **Unearned Premiums**

**\$244,083**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

#### **Reinsurance Payable**

**\$116,964**

This liability consists of amounts due to the company's reinsurer at December 31, 2002, relating to transactions which occurred on or prior to that date.

October Premium	\$ 29,869
November Premium	29,106
December Premium	31,895
Class A	1,194
Class C-1	13,200
Class C-2	2,100
Class D/E	<u>9,600</u>
Total	\$116,967

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability. The company was three months late in paying reinsurance premiums at year-end and as of the examination date the company was two months late and working at becoming current.

**Fire Department Dues Payable** **\$589**

This liability represents the fire department dues payable at December 31, 2002.

The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

**Commissions Payable** **\$5,554**

This liability represents the amounts owed by the company to its agents. As of December 31, 2002, \$2,284 of this balance is being held because of incomplete or missing paperwork from its agents. Some agents are not completing the Policy Renewal Underwriting Information Form the company has developed. It is recommended that the company require all agents to complete the Policy Renewal Underwriting Information Form.

**Accrued Property Taxes** **\$3,990**

This liability represents property taxes owed by the company at December 31, 2002. Supporting records and subsequent cash disbursements verified this item.

**Accrued Vacation and Sick Pay** **\$15,722**

This liability represents the employees' accumulated sick leave earned prior to December 31, 2002, which had not yet been paid. Employees receive 12 sick days per year and may accumulate up to 90 days. Upon termination the employee is paid half of amount accumulated. Supporting sick leave records were used to verify this item.

**Pension Liability Payable** **\$21,257**

This liability represents the balance payable at year-end for a life insurance policy liability incurred prior to December 31, 2002, where the company is the policyholder and beneficiary.

The examiners reviewed the company's calculation to verify the accuracy of this liability.

**Premiums Received in Advance**

**\$17,008**

This liability represents the balance of premiums received prior to December 31, 2002, for policies becoming effective in 2003.

The examiners reviewed the company's system report and verified amounts paid by policyholders were received before December 31, 2002, to verify the accuracy of this liability.

**Other Liabilities**

**\$0**

This liability represents the balance payable at year-end for the company's retention for liability losses incurred prior to December 31, 2002. The company reported \$2,250 as the balance of this account. A reclassification entry was made to transfer this balance to Unpaid Losses, where the amount should have been reported. A recommendation was made at the Net Unpaid Losses section of this report.

This amount was verified by tracing company payments in the subsequent year.

## **VI. CONCLUSION**

West Central Mutual Insurance Company is a town mutual insurer covering ten counties. The company has been in business since 1871.

Since the prior examination of December 31, 1998, the company's assets decreased 9% from \$1,255,922 to \$1,147,209 in 2002. Liabilities have increased 55% from \$284,727 in 1998 to \$440,925 in 2002. Surplus decreased 27% from \$971,195 in 1998 to \$706,284 in 2002. Policy counts have increased from 1,282 in 1998 to 1,397 in 2002. The company has suffered net losses three out of the four years under examination; its last underwriting gain was in 1994. The loss in 2002 was (\$24,686).

Actions the company has taken to improve results include increasing premiums, hiring an internal adjuster/appraiser to help with claims and underwriting, lowering commissions paid to agents, and not paying commissions to agents until all the completed paperwork is provided to the company. The company expects these actions will improve its future financial performance.

The examination resulted in eleven recommendations. The recommendations are listed in the next section of this report.

## VII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 17 - Corporate Records — It is recommended that when the board wishes to change the number of members on the board that it do so by resolution according to Article III of the company's articles of incorporation.
2. Page 17 - Corporate Records — It is recommended that the board minutes reflect what committees are being assigned and list the members of each committee and the chairman of each committee.
3. Page 17 - Corporate Records — It is recommended that the company divide the classes into more evenly distributed classes pursuant to s. 612.13 (1), Wis. Stats.
4. Page 18 - Conflict of Interest — It is recommended that those directors who have indicated a conflict of interest abstain from voting when such a conflict exists, pursuant to ss. 612.18 and 611.60, Wis. Stats.
5. Page 18 - Fidelity Bond and Other Insurance Coverage — It is recommended that the company report the correct name of its Fidelity Bond insurer on the Annual Statement.
6. Page 19 - Underwriting — It is recommended that the company develop a written performance standard for its agents and that the company develop a process to review agent performance, such process should include appropriate remedial action for those agents who do not meet the performance standard.
7. Page 23 - Cash and Invested Cash — It is recommended that the company properly mark checks void and keep voided checks in a secure place.
8. Page 23 - Cash and Invested Cash - It is recommended that the company properly accrue for unrecorded liabilities at year-end according to the Annual Statement Instructions.
9. Page 25 - Agents' Balances or Uncollected Premiums — It is recommended that the company non-admit amounts in Agents' Balances or Uncollected Premiums over 90 days pursuant to the Annual Statement Instructions.
10. Page 27 - Net Unpaid Losses — It is recommended that the company properly report all losses unpaid as net unpaid losses on its annual statement.
11. Page 27 - Net Unpaid Losses — It is recommended that the company estimate an IBNR for liability losses each year.
12. Page 29 - Commissions Payable — It is recommended that the company require all agents to complete the Policy Renewal Underwriting Information Form.

### **VIII. ACKNOWLEDGMENT**

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, DuWayne Kottwitz of the Office of the Commissioner of Insurance (OCI), State of Wisconsin, participated in the examination:

Respectfully submitted,

David A. Grinnell  
Examiner-in-Charge